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SUBJECT: A/S GLASER'S AUGUST 25-26 VISIT TO CHILE:
SCENESETTER

REF: SANTIAGO 1712

1. Summary: Following a successful run on the international stage, Chile is shifting its focus to domestic issues and its December 11 presidential and congressional elections. Former Defense Minister and ruling coalition candidate Michelle Bachelet is the favorite to succeed President Lagos. Chilean chief executives are legally barred from seeking re-election. All three main presidential candidates are likely to keep the country and our relationship on track. Chile's economy is robust and stable. In June, a historic, country-wide judicial reform went into effect in Santiago, the last of the municipalities. Chile's Financial Intelligence Unit (FIU) has taken positive steps to combat money laundering and terrorist finance. However, the Constitutional Court deemed laws empowering the FIU unconstitutional in early 2004; new legislation designed to restore those powers has been submitted to Congress but not passed. A general lack of awareness and, in some instances, denial complicates Chile's ability to combat money laundering. Chile remains on the terrorists' least desirable list, but its porous northern region provides easy access for terrorism financing and narcotics trafficking. A Department of Treasury team visited Chile during the week of July 25-29 to assess Chile's gaming industry. The team will return during the week of September 12-16 (at Chile's request) to assist the GOC in developing a structure to review potential casino vendors. End summary.

FROM APEC TO COMMUNITY OF DEMOCRACIES

2. Minister of Interior Jose Miguel Insulza's May election as OAS Secretary General capped a successful six-month run on the international stage for Chile. During this time, Chile hosted two high-level international meetings (APEC Leaders' Week and Community of Democracies Ministerial), concluded (in December 2004) a productive two-year term on the UNSC, and maintained a leadership role in Haiti peacekeeping efforts. Throughout, Chile generally proved to be a reliable and rational partner for the U.S.

DOMESTIC SCENE

3. Chile will hold presidential and congressional elections on December 11, 2005. This will be Chile's fourth presidential election since the end of the Pinochet era in 1989. The previous three elections were judged free and fair, and there is no reason to expect otherwise for the upcoming one. There are currently four presidential candidates: the Socialist Party's Michelle Bachelet (representing the ruling Concertacion coalition); the Independent Democratic Union's Joaquin Lavín; the National Renewal's Sebastian Pinera; and the Communist Party's Tomas Hirsch. (President Ricardo Lagos, who is riding high in the polls, as incumbent is constitutionally barred from serving consecutive terms.) Bachelet, the Concertacion's presidential candidate and former defense minister, is leading in the polls. She would become Chile's first female president if she wins. Half the seats in both the Senate and the Chamber of Deputies are also up for election on December 11. The new president and members of Congress will take office on March 11, 2006.

4. In recent years, Chile has taken a number of significant steps to strengthen democratic institutions and deal with the human rights abuses of the past. In November 2004, the National Commission on Political Prisoners and Torture (Valech Commission) issued a landmark report on human rights abuses during the Pinochet era, and the judicial system continues to investigate and prosecute a number of human rights cases. In June, a historic, country-wide judicial reform went into effect in Santiago, the last of the municipalities. In July, Congress passed a number of constitutional reforms designed to increase civilian control over the military.

ECONOMY

15. Chile's economy is the main reason behind President Lagos' 70 percent approval rating. The Chilean economy grew at an impressive 6.1 percent in 2004 -- almost double the rate in 2003 -- and may do even better in 2005, due in large measure to a boom in global copper prices. Bilateral trade increased over 30 percent during the first year of the U.S.-Chile Free Trade Agreement, and related cooperation on labor and environmental protection is going well. Chile's inadequate protection of intellectual property rights remains a significant sore point, and both sides are anxiously awaiting better, new market access for beef and poultry. The U.S. remains Chile's most important source of foreign investment, although Spain surpassed us in 2004 as the number one provider of foreign direct investment. Since 1990, U.S. firms have invested over USD 16 billion in Chile, with a concentration in the energy, telecommunications and mining sectors. U.S. companies generally praise Chile's mostly transparent but close-knit business climate.

Regional Issues

16. Chile has been increasingly willing to assume leadership roles in recent years. Former Minister of Interior Jose Miguel Insulza was elected OAS secretary general in May. In Haiti, Chile responded positively to the USG's request for support in February 2004, and self-deployed a battalion to Haiti within 48 hours. Chile currently has approximately 600 troops deployed there as part of the UN Mission, and a Chilean civilian serves as UN Special Representative. In May, the Chilean Congress voted to extend Chile's troop deployment for six months to December 2005, with a provision that the Government can extend the deployment for an additional six months to June 1, 2006. On Venezuela, despite its center-left political orientation, the governing Concertacion coalition is wary of President Chavez. The GOC shares our frustrations with the Venezuelan leader's behavior, particularly his non-democratic ways, and is concerned that his rhetoric and actions (especially regarding Bolivia) could prove destabilizing for the region. FM Walker met with the Venezuelan opposition group SUMATE in Santiago on August 9 (reftel).

MONEY LAUNDERING

17. Money laundering is a criminal offense in Chile. In December 2003, Congress passed a law calling for the creation of Chile's Financial Intelligence Unit (FIU), in part due to Chile's past failure to meet the international Egmont Standards. The law requires that annual reporting of suspicious transactions by the financial sector become mandatory. All cash transactions exceeding USD 12,000 must be recorded, and Chilean customs requires declaration of cash in excess of USD 10,000. The law also expanded the definition of money laundering beyond narcotics-related activity to include any act of terrorism, illegal arms trafficking, fraud, corruption and prostitution. Oversight of non-financial sector entities, such as money exchange houses and the gaming sector, was not included in the law.

18. In early 2004, Chile's Constitutional Court deemed unconstitutional several aspects of the law. This adversely impacted the FIU's ability to obtain information, lift bank secrecy provisions, freeze assets, and impose sanctions. Chile's stringent bank secrecy laws and deference to privacy appear to have been motivating factors behind the ruling.

FINANCIAL INTELLIGENCE UNIT

19. The FIU opened its doors in April 2004 under the direction of Victor Ossa, a former postal executive, and began receiving Suspicious Transaction Reports (STRs) from the formal banking center. Six months later, 25 STRs had been submitted. In October 2004, FINCEN representatives deemed the FIU as fully functional and in compliance with the Egmont definition of an FIU. Today, a staff of 12 receives approximately 10 STRs per month.

110. The laws governing the FIU do not specify a number of STRs to be received. Nor do they explain what constitutes a suspicious activity, or provide sanctioning capability for reporting or not reporting suspicious activities. With the country-wide implementation of judicial reform, any suspicious case involving money laundering requiring additional investigation is referred to the Public Ministry. The FIU has neither investigative powers nor powers to obtain court orders. Nor can it obtain information from banks other than through an STR, which is initiated by the bank at its discretion. Since the FIU's inception, no criminal cases have been opened. Legislation that restores sanctioning powers, eases bank secrecy laws during investigations, and

allows access to third party information is needed for the FIU to become fully functional.

COUNTER-TERRORISM/COUNTER-NARCOTICS

¶12. Chile remains on the terrorists "least desirable" list in the hemisphere. The GOC has been supportive of U.S. counter-terrorism policies, particularly during its time on the UNSC. Chile is a signatory to all 12 UN anti-terrorism conventions and protocols, and the UN International Convention for the Suppression of the Financing of Terrorism.

¶13. The northern area of Chile is a focal point in the area of terrorism financing and narcotics trafficking. This is due in part to Chile's border with Peru and Bolivia and the free-trade zone in Iquique, Chile. Arica and Iquique, Chile's principal northern cities, are the main points of entry for the bulk of the cocaine which enters Chile from Peru and Bolivia through the land ports as well as by maritime traffic. Chilean police estimates have two tons of cocaine being stockpiled in Arica on a monthly basis. Money (generally euros or pesos) also takes advantage of the porous northern region, and is frequently trafficked along the same drug routes or sent directly to Santiago.

¶14. Iquique is home to the Iquique Free Trade Zone (ZOFRI), which is known for its cheap products made primarily in China and Taiwan, as well as the importation and sale of used cars and car parts. The bulk of these products are sold and exported to Peru, Bolivia, and the tri-border areas of Paraguay, Brazil and Argentina. There is a growing Pakistani and Lebanese population in Iquique with business ties to the Free Trade Zone.

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